

Section II

Financial Statement Findings

Department of Corrections

Introduction

The Department of Corrections manages the State's adult correctional facilities and the adult parole system. The Department also operates the Prison Canteens and the Division of Correctional Industries. The canteens provide various personal items for purchase by inmates, including toiletries, snack foods, and phone services. Correctional Industries operates a furniture manufacturing facility, various farming and ranching facilities, Colorado State forms production and distribution facilities, an automotive service station, the State's license plate manufacturing facility, and management of the State's surplus property.

The Department's Fiscal Year 1999 operating budget was approximately \$400 million with 4,771 full-time-equivalent staff (FTE). Administrative offices for the Department are located in Cañon City and Colorado Springs. Correctional facilities are located throughout the State and include Buena Vista, Cañon City, Denver, Pueblo, Limon, Ouray, Delta, Rifle, and Sterling.

The following comments were prepared by the public accounting firm of Baird, Kurtz & Dobson, who performed audit work at the Department of Corrections.

Inventory of the Central Pharmacy

The Department of Corrections' Central Pharmacy (Pharmacy) in Cañon City handles the majority of the inmates' prescriptions within the Department. In prior year findings we stressed the importance of a perpetual inventory tracking system for prescriptions. We recommended that measures be taken to improve the perpetual inventory system for tracking quantities on hand, received, and dispensed for each inventory item. Proper segregation of duties is a critical part of establishing the proper control environment. Proper procedures combined with effective segregation of duties would help ensure that drugs are not misused or stolen.

As a result of the prior year finding, the Department has implemented policies to maintain control of the inventory located in the Pharmacy. We have reviewed these policies and tested for their implementation and effectiveness and found no control deficiencies. We have, however, noted a better means of recording and controlling transactions of obsolete inventory returning to the Central Pharmacy.

The Pharmacy maintains a handwritten perpetual inventory log for recording transactions of controlled substances. During our observation of inventory we noted obsolete or outdated inventory was being returned to the Pharmacy but not recorded in the perpetual inventory until removed by the company contracted to destroy such controlled substances. This creates a situation where expired drugs are not on the perpetual inventory listing and the potential for misuse increases because there is no control log during this period of time.

Recommendation No. 1:

The Department of Corrections should make an entry in the perpetual inventory system to record the receipt of all pharmaceuticals transferred into or out of the Pharmacy.

Department of Corrections Response:

Agree. The Central Pharmacy has implemented this additional record keeping step.

Department of Health Care Policy and Financing

Introduction

The Department of Health Care Policy and Financing (HCPF) was created as part of the restructuring of state departments under House Bill 93-1317 effective on July 1, 1994, or the beginning of Fiscal Year 1995. The Department is the state agency responsible for administering the Medicaid program, the federal program designed to provide health services to eligible needy persons. HCPF contracts with the Department of Human Services for some services, such as determining individuals' eligibility for Medicaid benefits. The Medicaid grant is the largest federal program administered by the State and is funded approximately equally by federal funds and state general funds. During Fiscal Year 1999 the Department expended almost \$1.91 billion and had 159 full-time-equivalent staff (FTE), compared with \$1.67 billion in expenditures and 146 FTE in Fiscal Year 1998.

During Fiscal Year 1999 the Department continued to work on developing an expanded children's health insurance program for children 18 years of age and under as authorized by House Bill 97-1304, referred to as the Children's Basic Health Plan or Children's Health Plan Plus. In October of 1997 the Department submitted the State's plan for children's health insurance to the federal government in order to obtain federal funds for these types of programs under the federal Title XXI, the Children's Health Insurance Program.

The public accounting firm of Baird, Kurtz & Dobson (BKD) performed the audit work at HCPF as of and for the fiscal year ended June 30, 1999. During its audit BKD reviewed and tested HCPF's internal controls over financial reporting and federal programs, including compliance with certain state and federal laws and regulations, as required by generally accepted auditing standards, *Government Auditing Standards* and U.S. Office of Management and Budget (OMB) Circular A-133.

Obtain Approval for Cost Allocation Plans

Under federal regulations, entities that receive federal awards, referred to as grantees, may be reimbursed for a portion of indirect costs related to operating a federal program. Indirect costs, or overhead costs, are those costs that benefit more than one program or activity, such as a staff person that performs accounting functions for multiple programs. To recover indirect costs, organizations must develop a cost allocation plan (CAP, plan) that provides a reasonable and consistent basis for allocating costs in the indirect cost pool to the various programs and activities that benefit from these costs. The CAP must be prepared in accordance with applicable OMB guidelines, and the plan must be submitted to and approved by the federal government.

During the Fiscal Year 1998 audit, it was noted that the Department did not have approved cost allocation plans in place for the years since it was created in Fiscal Year 1995. The Department agreed to increase its efforts to submit the CAPs and work to obtain federal approval. During the Fiscal Year 1999 audit, BKD found that Fiscal Year 1997 was the only year for which the Department had an approved CAP. Subsequent to the audit HCPF received approval for its Fiscal Year 1996 CAP in October 1999. In terms of the other outstanding years, the Department submitted a proposal for the Fiscal Year 1995 CAP in June 1996 that was not approved, and the Department has not yet resubmitted it. HCPF has not submitted proposed CAPs for Fiscal Years 1998 or 1999.

Implementation of Additional Programs and Impact on Indirect Costs

With the addition of the Children's Health Insurance Program (CHIP) to the Department's responsibilities in Fiscal Year 1998, many personnel whose salaries are part of the Department's indirect cost pool began devoting time and effort to multiple programs, such as Medicaid and CHIP. Accordingly, the methodology used in the approved Fiscal Year 1997 CAP is inappropriate for Fiscal Years 1998 and 1999. HCPF has not performed time and effort studies or maintained other documentation such as personnel activity reports to support the allocation of these personnel costs in the indirect cost pool to the various programs that benefit from these costs. During

Fiscal Years 1998 and 1999, the Department has continued to charge a portion of indirect costs to the Medicaid program; however, it has not charged any indirect costs to CHIP. Accordingly, the entire federal share of indirect costs claimed under the Medicaid and Medicaid-related programs for Fiscal Year 1999 in the amount of \$2,493,611 is questioned as to its appropriateness.

Without an approved cost allocation plan in place, the federal government could choose not to continue reimbursing the State for the federal share of indirect costs incurred by the Medicaid program. In addition, the federal government could disallow indirect costs already reimbursed to the State and require that they be repaid. This would drastically increase the cost to the State for operating the Medicaid program. (CFDA Nos. 93.775, 93.777 and 93.778—Medicaid Cluster—Allowable Costs (Cost Allocation Plan).)

Indirect Costs and the Children's Health Insurance Program

In terms of CHIP, the federal reimbursement rate is 65.42 percent, which is higher than the 50 percent reimbursement rate for indirect costs under the Medicaid program. By not charging indirect costs to CHIP the State appears to be under recovering federal funds, thus unnecessarily increasing the burden on the State's General Fund. Without an approved allocation methodology, and cost allocation plan, the amount of this underrecovery is not known. This is further complicated by the fact that the State currently exceeds the allowable 10 percent non-benefit activity cost levels for CHIP, and indirect costs are considered part of these non-benefit activity costs (see Recommendation No. 6).

Finally, since the Department is charging some indirect costs to Medicaid that should be charged to CHIP, the State is shifting CHIP costs to Medicaid. Shifting costs between federal programs is not allowable under federal regulations. This could be of particular concern because costs are being shifted from a capped grant award (CHIP) to a federal entitlement program where the award is not capped (Medicaid). However, as of June 30, 1999, the State had used only \$7.2 million of its initial \$41.8 million federal grant award for CHIP, or about 17.2 percent. In other words, even if a share of indirect costs were charged to CHIP, the State is unlikely to exceed the award amount; however, by charging a portion of indirect costs to CHIP the State would increase the amount by which it exceeds the allowable 10 percent level of non-benefit activity costs. The State has until September 30, 2000, to use the remaining \$34.6 million balance on this first award. (CFDA No. 93.767—State Children's Insurance Program—Allowable Costs (Cost Allocation Plan).)

Recommendation No. 2:

The Department of Health Care Policy and Financing should prioritize completion and submission of cost allocation plans for Fiscal Year 1999 as well as Fiscal Years 1998 and 1995. As part of this process, the Department should develop appropriate documentation of time and effort studies or a similar methodology to support the plans to be submitted as required by OMB Circular A-87, Cost Principles for State, Local, and Indian Tribal Governments.

Department of Health Care Policy and Financing Response:

Agree. The Department made the cost allocation plans a top priority in Fiscal 98-99 and was successful in obtaining federal approval on two plan years to date (Fiscal Year 95-96 and Fiscal Year 96-97). In addition, we will have the plan for Fiscal Year 94-95 submitted to the federal Health Care Finance Administration (HCFA) on February 1, 2000. Additionally, we plan to have the Fiscal Year 97-98 plan submitted to HCFA by March 1, 2000. That will leave only the Fiscal Year 98-99 and Fiscal Year 99-00 plans to be resolved. As part of our efforts to become current with our plans, we will develop an appropriate methodology that is acceptable to the federal government to support the allocation of all costs claimed. Our goal is to be current with our cost allocation plans by July 1, 2000.

Allowable Costs Under Medicaid

Under the federal Medicaid program, certain expenditures are considered allowable costs and thereby qualify for reimbursement by the federal government. Out of the total Medicaid program expenditures of \$1,761,088,128 for Fiscal Year 1999 (federal share \$905,564,250), an audit sample of 217 program expenditures with a value of \$5,824,487 (federal share \$2,946,608) was tested for allowability under Medicaid regulations.

The evaluation of the sample identified 54 program expenditures that did not comply with one or more allowable cost criteria for the Medicaid program. These 54 sample items had a value of \$11,674 (federal share \$5,906). The errors were as follows:

Third Party Resources: Fourteen instances were found in which the beneficiary's Medicare or other third party resource information was entered into the Medicaid Management Information System (MMIS) subsequent to the date the claim was paid. There was no evidence noted in these files showing subsequent attempts to bill the third party. Federal regulations state that where a third party liability is established after the claim is paid, reimbursement from the third party should be sought (42 CFR §433.135 through 433.154). The Department risks being required to refund federal reimbursement dollars if third party resources are not properly pursued and billed.

Claims Supported by Medicaid Records: There were three instances in which an Electronic Data Interchange (EDI) agreement was not available for review. EDI agreements are required in cases where medical providers submit claims for payment in batches. These agreements are the provider's attestation they have appropriate medical records to support the claims. To be allowable under Medicaid, costs for medical services must be supported by medical records. Without confirming these agreements are in place with providers, the Department does not adequately ensure providers have supported medical records for the claims submitted. Payments for claims unsupported by medical records are not allowed under the Medicaid program.

Prescription Credits: In 33 sample items, documentation was not present to indicate whether prescriptions were actually picked up by the Medicaid recipient within the prescribed 14-day period. Regulations allow the costs for prescriptions only if the client obtains the prescription within 14 days. Should a client not pick up a prescription within 14 days, the provider is required to credit the original reimbursement back to the program. This requirement is stated clearly in the Pharmacy Provider Manual supplied by HCPF. Currently there is no control in place ensuring that the Department receives credits for all prescriptions not picked up by beneficiaries within the allowable 14-day period.

HCPF is in the process of preparing an amendment to the pharmacy provider agreements requiring the provider to maintain a signature log. These signature logs will greatly assist the Department with postpayment reviews. Such reviews are a very necessary process for maintaining control over prescription drugs. Over \$62 million of federal funds alone were distributed in Fiscal Year 1999 for these types of payments.

Recommendation No. 3:

The Department of Health Care Policy and Financing should ensure payments are made only for allowable costs under the Medicaid program by:

- a. Implementing control procedures to ensure Medicare or other third party resources are exhausted.
- b. Establishing a postpayment review of claims to identify claims that could be recovered from Medicare and other third party resources and undertaking appropriate collection efforts.
- c. Requiring all claims submitted for payment have detailed support at the client level.
- d. Ensuring that Electronic Data Interchange agreements are current for every provider submitting batch transactions before payment is made for those claims.
- e. Amending the pharmacy provider agreements to require providers periodically submit or otherwise make Medicaid recipient signature logs accessible to HCPF to facilitate postpayment reviews.

Department of Health Care Policy and Financing Response:

- a. Agree. The third party liability was known at the time the claim was processed, and the claim was paid correctly in a pay and report status. It is agreed that the Department did not complete the process in this cycle of working that report to ensure that Medicare or other third party carrier resources were indeed exhausted or that in fact the service rendered was a benefit under that carrier. Corrective actions are being implemented by February 2000 as noted below in b.
- b. Agree. When claims are paid recognizing that there is a third party carrier for the service rendered, the claim line sets a pay and report edit. The State will review the report to assure appropriate billing by the provider. Rather than requiring postpayment review of claims paid, our home health policy analyst is proceeding with a change in the process of how home health claims are paid. An edit will be added that requires the provider obtain a Medicare denial before acute home health claims are paid. Without that denial, those claims will be denied, and the pay and report edit will not be utilized for the specified home health codes.
- c. Agree. Refer to response provided in Recommendation No. 25a and b.
- d. Agree. Refer to response provided in Recommendation No. 25a and b.

- e. Agree. HCPF personnel will be meeting with pharmacy providers during December 1999 to determine the best method of obtaining needed information. Provider agreements will be amended based on the results of this meeting. This will be completed prior to March 31, 2000.

Controls Over Automated Systems

The Medicaid program is dependent on extensive, complex computer systems and the internal controls over such systems for ensuring the proper payment of Medicaid benefits. Federal regulations (45 CFR 95.621) require state agencies to establish and maintain a program for conducting a biennial risk analysis and system security review of automated data processing (ADP) systems for the Medicaid program. The purpose of these requirements is to ensure that appropriate, cost-effective controls and safeguards are incorporated and operating effectively in both new and existing systems.

As described earlier, HCPF has a contract with a nongovernmental service organization that functions as the fiscal agent for the Medicaid program. This fiscal agent processes all provider payments for the Medicaid program, which totaled over \$1.76 billion in Fiscal Year 1999. The fiscal agent is responsible for the operation of the Department's new Medicaid Management Information System (MMIS) put in place during Fiscal Year 1999, which is the automated system that processes all claims for payment under the Medicaid program.

HCPF was able to provide substantial documentation from its fiscal agent for the MMIS. HCPF was also able to provide documentation of numerous meetings and discussions with the fiscal agent regarding the testing performed by the fiscal agent of the new MMIS as part of the conversion to the new system.

However, the Department has not performed and documented the on-site risk analysis and system security review required by federal regulations for MMIS. In addition, HCPF has not obtained an independent audit of the controls over MMIS or other documentation that would demonstrate controls over the system have been verified. (CFDA Nos. 93.775, 93.777 and 93.778—Medicaid Cluster—Special Tests and Provisions (Automated Data Processing).) The Department can help ensure the reliability of the MMIS by performing the necessary reviews over the system.

Recommendation No. 4:

The Department of Health Care Policy and Financing should ensure adequate controls are in place over automated systems for the Medicaid program by:

- a. Performing and documenting the required analysis under federal regulations for the Medicaid Management Information System and following up on any corrective action deemed necessary as a result of that analysis.
- b. Consider including a requirement that the fiscal agent obtain an independent assessment of controls over the Medicaid Management Information System on an annual or biennial basis.

Department of Health Care Policy and Financing Response:

- a. Agree. Subsequent to the audit, the Department received notification (October 1, 1999) from HCFA (Health Care Financing Administration) that the current MMIS was certified retroactive to December 1, 1998 (implementation date). This was based on HCFA's on-site review that was conducted July 26-30, 1999, which included security. In addition, the Department did review the "Colorado State Auditor's Office – Possible Control Procedures for I/S Auditing" and the fiscal agent is meeting all possible control procedures. The Department will create and implement a periodic risk analysis review process effective July 1, 2000 in accordance with the federal regulations (45 CFR 95.621).
 - b. Partially agree. The Department and the fiscal agent have and continue to maintain adequate controls that address security and confidentiality issues. Additionally, due to the recent implementation of the new MMIS on December 1, 1998, which required the Department to complete the security requirement based on the RFP and HCFA guidelines, the Department will consider, but at the current time cannot commit to, requiring the fiscal agent to obtain an independent assessment over the controls over the MMIS on an annual or biennial basis. This requirement would result in a supplemental request, a contract amendment with the fiscal agent (because this is not required in 45 CFR 95.621) and cost about \$50,000-\$70,000. The Department will agree to create an annual plan to review the controls by March 31, 2000, which is within compliance of 45 CFR 95.621.
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Drawdowns of Federal Funds for the Medicaid Program

The audit found some problems with controls over the process for drawdowns of federal funds made to receive reimbursement for the federal share of Medicaid expenditures. Out of 30 drawdowns tested during the audit, one occurrence of a duplicate drawdowns of federal funds was discovered for Fiscal Year 1999. This error occurred in relation to the Medicaid Disproportionate Share Hospital program. Transactions for this program require staff to perform several manual interventions in the Department's automated system for federal drawdowns, and in this case a required manual adjustment was not made to a system-generated federal drawdowns. This error was identified by the Department and corrected within 30 days.

In addition, during the testing of fiscal year-end balances we found that, as of September 10, 1999, the June 30, 1999, federal receivable of \$54.9 million for Medicaid was still outstanding. We determined that HCPF had overspent its quarterly available funds for the period ending June 30, 1999. Through an oversight, the Department had not identified the outstanding amount and requested supplemental funding from the federal government in order to increase the allotment and cover the excess expenditures. Because the supplemental request was not filed, \$54.9 million of state funds were utilized to cover Medicaid costs for the intervening period, when these costs should have been reimbursed with federal dollars. Subsequently, the Department requested the supplemental and made the drawdowns for the \$54.9 million in federal funds.

On the basis of the average interest earned by the State Treasurer on the State's pooled cash funds during July and August 1999, we estimated that the use of state funds to carry the \$54.9 million for the federal share of the Medicaid program resulted in a cost to the State of approximately \$537,500. The Department needs to improve oversight of the drawdowns process to help ensure such errors do not occur in the future. (CFDA Nos. 93.775, 93.777 and 93.778 Medicaid Cluster–Cash Management (Cash drawdowns).)

Recommendation No. 5:

The Department of Health Care Policy and Financing should enhance control procedures and review processes for federal drawdowns under the Medicaid program by:

- a. Establishing standardized procedures that specifically address the manual Disproportionate Share Hospital program transactions and prevent duplicate federal drawdowns.
- b. Implementing review procedures at the end of each quarter that compare expenditures and allotments and determine if a request for supplemental federal funds needs to be submitted to reduce the State's exposure for unnecessarily fronting the cost of the Medicaid program.

Department of Health Care Policy and Financing Response:

- a. Agree. The Department does have standardized procedures to address the unique nature of the Disproportionate Share program. A human error did occur, but the procedures in place quickly caught and corrected the error.
- b. Agree. Again, the Department has procedures in place to ensure that adequate federal authority exists in the federal cash management system. Due to a staffing issue, an experienced staff member was performing this as a new duty, and unfortunately missed the problem condition. We will review our existing procedures and staff assignments to ensure that they are both appropriate and adequate. This review will be completed by February 28, 2000.

Strengthen Monitoring and Reporting for the Children's Health Insurance Program

The audit included a review of the Department's internal controls and compliance related to federal requirements for the Children's Health Insurance Program (CHIP). This is the State's subsidized insurance program for children in low-income families that exceed Medicaid income limitations. The Department expended a total of about \$16.3 million from all funding sources for this program for Fiscal Year 1999.

Federal Draws for Non-Benefit Activities Under CHIP

Federal Title XXI allows for federal reimbursement to states for a share of "non-benefit activity" expenditures for CHIP, and the law limits qualifying non-benefit expenditures to 10 percent of total program expenditures. Eligible non-benefit activities include administration and other specified costs such as outreach programs. The law does not provide a federal match for non-benefit expenditures exceeding the 10 percent limit.

The federal Health Care Finance Administration (HCFA) has issued a letter to the states allowing them to delay submitting claims for non-benefit expenditures in excess of the 10 percent limit to the subsequent fiscal year. HCFA has verbally informed the Department that states are allowed to draw the related federal share of these excess expenditures without reporting either the excess expenditures or related federal draws on the corresponding quarterly reports to HCFA. Normally, states are required to file reports to the federal government based on actual expenditures made and actual federal reimbursement received during the quarterly reporting period. The Department is required to maintain a reconciliation between the amounts reported and the excess non-benefit expenditures and federal draws made. The reconciliation is submitted to HCFA along with the federal quarterly report.

HCFA indicated to the auditors that this practice is being permitted to assist states with funding program start-up costs for CHIP that may result in states exceeding the 10 percent limit. HCFA has not indicated verbally or in writing how long it will allow states to follow these procedures. HCFA's expectation is that as enrollments and benefit expenditures increase, the relative share of non-benefit activity costs will drop to the 10 percent level.

When HCFA discontinues this practice, the 10 percent limitation in federal law will be enforced. It is not known what time frame or flexibility, if any, HCFA might allow the states in order for them to achieve compliance or face a disallowance for federal draws received related to non-benefit costs over the 10 percent limit. As of June 30, 1999, the Department reports that it had received about \$1.8 million in federal matching funds for non-benefit expenditures in excess of the 10 percent limit. In total, the Department had expended about \$3.9 million on non-benefit activities, which represented approximately 28.3 percent of total program expenditures reported to HCFA since the program's inception.

Further, the Department itself has not been charging any share of its own indirect costs to CHIP. Therefore, the actual level of non-benefit activity costs is higher than the \$3.9 million. The amount of indirect costs attributable to CHIP is not known

because the Department does not have a federally approved cost allocation plan in place that includes CHIP (see Recommendation No. 2.).

Federal Liability Should Be Recognized

Regardless of HCFA's decision at this time not to enforce the 10 percent limitation on non-benefit activity costs relative to federal reimbursement, the Department's related receipt of \$1.8 million in federal funds is not in compliance with federal law. It is understandable that the Department is taking advantage of the opportunity to provide additional funds to establish the Children's Basic Health Plan in Colorado using CHIP funds. However, the State should report this \$1.8 million in federal funds as a liability on its financial statements. The Department should consult with the State Controller's Office to determine the proper method to record this liability, and it should adjust the amount quarterly as federal reports are filed.

In addition, program and accounting staff at the Department need to develop a strategy for reducing non-benefit activity expenditures to the required level to avoid a possible disallowance by the federal government. Finally, the Department should report regularly to the General Assembly on the success of the Department's efforts to reach the 10 percent limit and the status of the federal liability. The information should be included in the quarterly report the Department is required to submit to the Joint Budget Committee (JBC) on administrative costs, enrollment efforts, and caseloads (HB98-1401, Footnote #51a; SB99-215, Footnote 63). We noted that the Department included this information in quarterly reports to the JBC up through June 30, 1999. However, it discontinued these disclosures in reports dated October 1, 1999, and January 1, 2000. (CFDA No. 93.767—State Children's Health Insurance Program—Matching, Level of Effort, Earmarking.

Auditor's Addendum

Subsequent to our audit, the federal Health Care Finance Administration notified the Department that as of September 30, 2000, the State would be required to comply with the 10 percent limit on qualifying non-benefit expenditures for the purposes of receiving federal reimbursement. This is further indication that the State should report a liability for excess federal reimbursements for CHIP and that the liability should be adjusted quarterly based on federal reporting periods. The Department reports that as of December 31, 1999, it had received \$1.9 million in federal reimbursement for non-benefit expenditures in excess of the 10 percent limit, or an increase of about \$100,000 since June 30, 1999.

The Department's response below has been revised by Department staff to reflect HCFA's decision to enforce the 10 percent limit.

Recommendation No. 6:

The Department of Health Care Policy and Financing should recognize and work to meet federal limits for non-benefit activity costs under the Children's Health Insurance Program (CHIP) by:

- a. Recording a liability for federal reimbursement received related to expenditures in excess of the 10 percent limit and updating this information quarterly.
- b. Developing a strategy to ensure non-benefit activity costs are appropriately reduced.
- c. Informing the General Assembly on the status of reducing non-benefit activity costs for CHIP to the required level under federal regulations and the amount of the related liability to the federal government as part of its quarterly report to the Joint Budget Committee on administrative costs, enrollment, and caseloads.

Department of Health Care Policy and Financing Response:

- a. Agree. The Department understands that we are in violation of the law; however, this violation occurred with the prior permission and knowledge of the local office of the federal administering agency for the Children's Health Insurance Program (the federal Health Care Finance Administration--HCFA). Up until February 1, 2000, we had no indication from HCFA how long we would be able to operate in this manner. Because there was no "due date," we were unable to estimate the amount due and as such we did not feel it was appropriate to record a liability. However, on February 1, 2000, we were informed by HCFA that as of September 30, 2000, we will no longer be allowed to draw federal funds for non-benefit expenditures in excess of the 10 percent federal participation limit. We will record a liability by March 31, 2000, and adjust it quarterly.
- b. Agree. The Department is clearly aware of the federal government's 10 percent participation limit for what they define as non-benefit activity expenditures. It must be clearly understood that this limit only applies to the amount of administrative expenditures that the federal government will

provide match for. Total administrative expenditures may exceed the 10 percent cap by using additional State funds or funds from other sources without federal match.

The Department has been studying these non-benefit costs in an effort to determine how they can be appropriately and effectively minimized, regardless of whether state or federal funds are used to pay the costs. The Children's Health Insurance Program (CHIP) is new, and it is very important to the success of the program for costs defined as administrative to be adequate to allow the program to achieve the goal of providing insurance to uninsured children. For example, marketing and outreach costs are defined as administrative costs by the federal government; if expenditures for outreach programs for enrolling eligible children are insufficient, enrollments will not meet program objectives, but these costs can and do drive a substantial amount of administrative costs.

The Department and the CHIP Policy Board have actively addressed marketing and outreach budgeting and strategies in the context of overall program design, development, and budgeting. The Department's strategies for controlling administrative costs is comprised of three parts:

1. Decreasing administrative costs per enrollee, as start-up and fixed costs are distributed across an expanded number of enrollees.
2. Performance-based contracting for marketing and outreach, eligibility and enrollment and related administrative functions, with increasing emphasis on payment for attainment of measurable products and outcomes.
3. Spreading start-up costs across multiple years, including developing and employing systems that will reduce operational costs over an extended system life cycle.

Our budget proposal for Fiscal Year 00-01 is for no more than 10 percent administrative expenditures. It is clearly our intent to begin living within this 10 percent administrative cap during that fiscal year. To determine the impact of the plan, we will have to assess our status at the close of that fiscal year. Implementation of this recommendation should occur by June 30, 2001.

- c. Agree. The Department has been and intends to continue being completely open with the General Assembly on this issue. The Department addressed the issue at a very detailed level in the June 30, 1999, quarterly report to the Joint Budget Committee, which was required by Footnote #51a of the Fiscal Year 1998-99 Long Bill. It is true that this level of detail was not repeated in the October 1999 or January 2000 reports. (The quarterly reporting requirement was continued in the Fiscal Year 99-

00 Long Bill by Footnote #63.). The principal reason for this detail being excluded was a difference of opinion between the Department and HCFA as to what constitutes administrative expenditures in the program. This disagreement caused some ambiguity as to the actual dollar amount of the excess federal draws, and so the specifics were not included in the two reports. However, the issue continued to be addressed in other forums. The Department addressed the issue in both its Fiscal Year 99-00 supplemental budget request and its Fiscal Year 00-01 budget request. Our discussions with the General Assembly will be ongoing.

Department of Higher Education

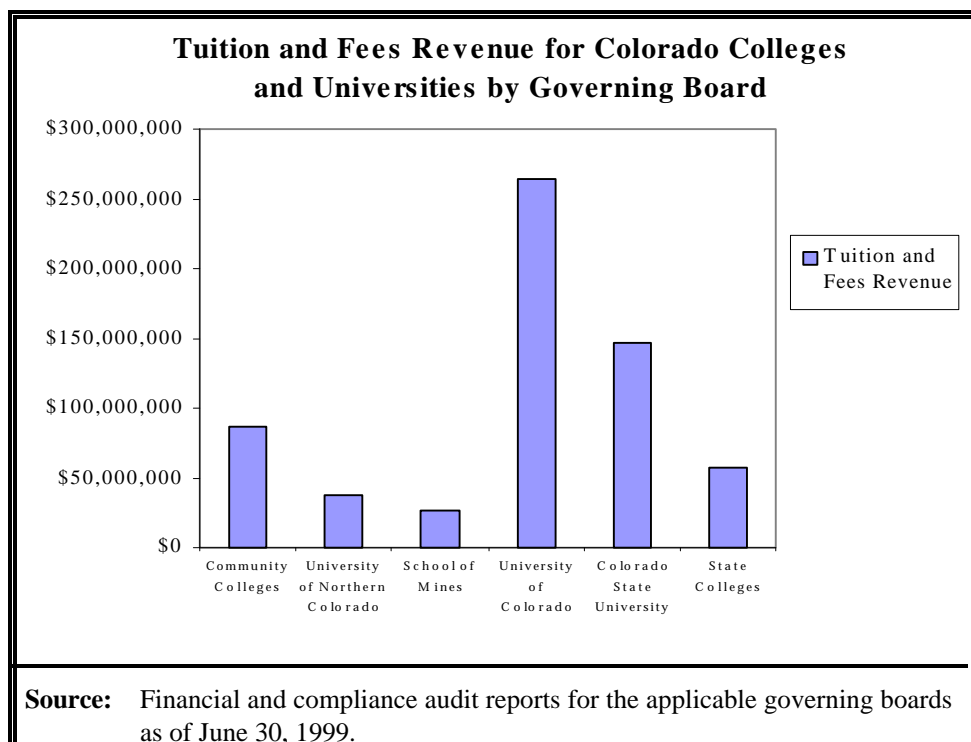
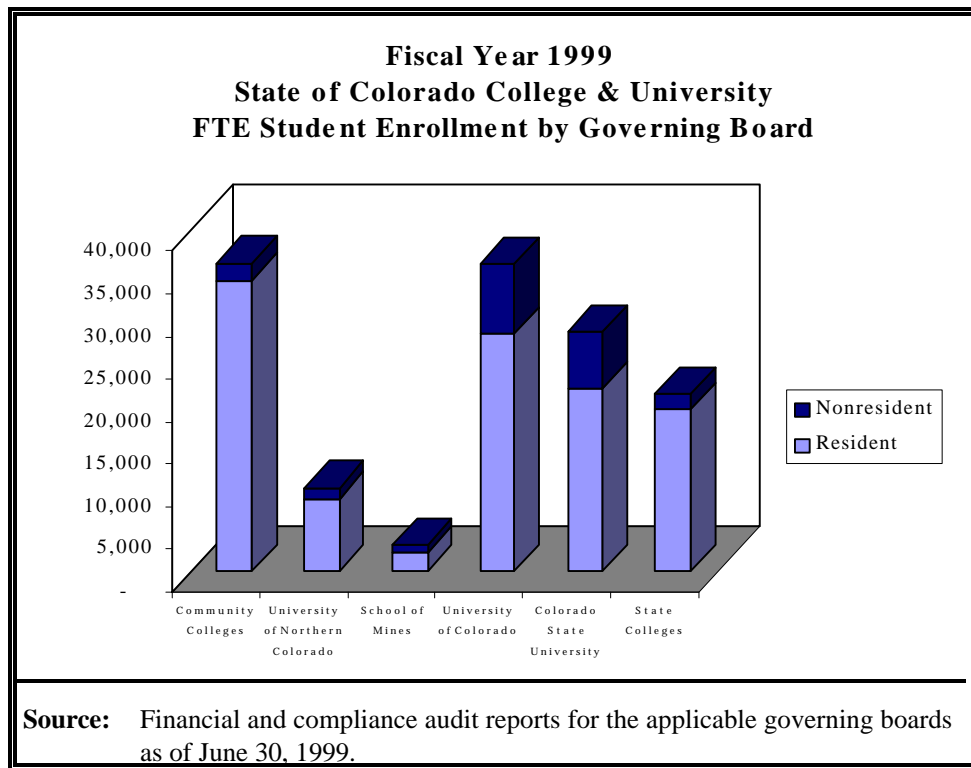
Introduction

The Department of Higher Education was established under Section 24-1-114, C.R.S., and includes all public education institutions in the State. It also includes the Auraria Higher Education Center, the Colorado Commission on Higher Education, the Colorado Council on the Arts, the Colorado Student Loan Division, the Colorado Historical Society, and the Division of Private Occupational Schools.

State public institutions of higher education are governed by six different boards. The governing boards and the schools they oversee are:

- **Board of Regents of the University of Colorado**
University of Colorado at Boulder
University of Colorado at Colorado Springs
University of Colorado at Denver
Health Sciences Center
- **State Board of Agriculture - Colorado State University System**
Colorado State University
Fort Lewis College
University of Southern Colorado
- **Trustees of the State Colleges of Colorado**
Adams State College
Mesa State College
Metropolitan State College of Denver
Western State College
- **State Board for Community Colleges and Occupational Education (SBCCOE)**
13 Community Colleges
- **Trustees of the University of Northern Colorado**
University of Northern Colorado
- **Trustees of the Colorado School of Mines**
Colorado School of Mines

The following graphs depict comparative data between the governing boards of the State's colleges and universities:



Board of Regents of the University of Colorado

The Board of Regents is constitutionally charged with the general supervision of the University and the exclusive control and direction of all funds of and appropriations to the University, unless otherwise provided by law. The University consists of four campuses: Boulder, Health Sciences Center, Denver, and Colorado Springs, as well as central administrative offices. Within the four campuses, 16 schools and colleges offer more than 140 fields of study at the undergraduate level and 100 fields at the graduate level.

University of Colorado

The University of Colorado was established on November 7, 1861, by Act of the Territorial Government. Upon the admission of Colorado into the Union in 1876, the University was declared an institution of the State of Colorado, and the Board of Regents was established under the State Constitution as its governing authority.

The following comment was prepared by the public accounting firm of KPMG LLP, who performed work at the University of Colorado.

Internal Control Over Compliance Requirements Can Be Improved at the Health Sciences Center (UCHSC)

As part of our audit, we tested compliance with federal, state, and University guidelines in accordance with *Government Auditing Standards*, Office of Management and Budget Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*, State Fiscal Rules, Statutes, and University policies. The following are internal controls over compliance matters that need improvement:

Office of Grants and Contracts Purchase Review

The UCHSC policy for purchases with federal funds is for the Office of Grants and Contracts (OGC) to review and approve all purchases over \$3,000. This policy is in place to ensure purchases are allowable in accordance with the grant agreement and federal guidelines. The normal operating procedure is for the requesting department to obtain OGC approval prior to submission to the purchasing department. If the purchasing department identifies a purchase order with restricted funds that has not been previously approved by the OGC, purchasing is to forward the purchase order back to that requesting department to obtain appropriate approvals. We noted in a

sample of fifteen federally funded fixed assets purchases, two were not approved by OGC in accordance with campus policy. These purchases were allowable under federal guidelines and the grant agreement; however, there is an increased risk that purchases may not be allowable if the OGC does not review the purchase. The UCHSC should ensure that departments and the new Consolidated Service Center are aware of the University policy relating to federally funded purchases and ensure appropriate approvals are obtained prior to disbursement of funds.

Federally Funded Fixed Asset Disposals

Office of Management and Budget Circular A-110, *Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations* (the Circular), outlines requirements related to equipment purchased with federal funds. The Circular states that:

“The recipient shall use the equipment in the project or program for which it was acquired as long as needed, whether or not the project or program continues to be supported by Federal funds and shall not encumber the property without approval of the Federal awarding agency. When no longer needed for the original project or program, the recipient shall use the equipment in connection with its other federally-sponsored activities, in the following order of priority: (i) activities sponsored by the Federal awarding agency which funded the original project, then (ii) activities sponsored by other Federal awarding agencies.”

The Circular further outlines requirements for the disposition of such equipment:

“When the recipient no longer needs the equipment, the equipment may be used for other activities in accordance with the following standards. For equipment with a current per unit fair market value of \$5,000 or more, the recipient may retain the equipment for other uses provided that compensation is made to the original Federal awarding agency or its successor. The amount of compensation shall be computed by applying the percentage of Federal participation in the cost of the original project or program to the current fair market value of the equipment. If the recipient has no need for the equipment, the recipient shall request disposition instructions from the Federal awarding agency. The Federal awarding agency shall determine whether the equipment can be used to meet the agency’s requirements. If no requirement exists within that agency, the availability of the equipment shall be reported to the General Services Administration by the Federal awarding agency to determine whether a requirement for the equipment exists in other Federal agencies. The Federal awarding agency shall issue instructions to the recipient no later than 120 calendar days after the recipient's request and the following procedures shall govern.”

If an asset acquired with federal funds is sold and proceeds are realized, the UCHSC offers the proportionate share to the federal awarding agency. If the asset is not sold, the UCHSC does not contact the awarding agency and request disposition instructions in accordance with federal regulations. As a result, the UCHSC may be in violation of the Circular requirements relating to equipment dispositions. However, our testwork did not note any instances of noncompliance.

The UCHSC should implement a process to identify disposals of federally-funded assets with a current fair market value of \$5,000 and ensure the sponsoring agency is contacted for disposition instructions.

Recommendation No. 7:

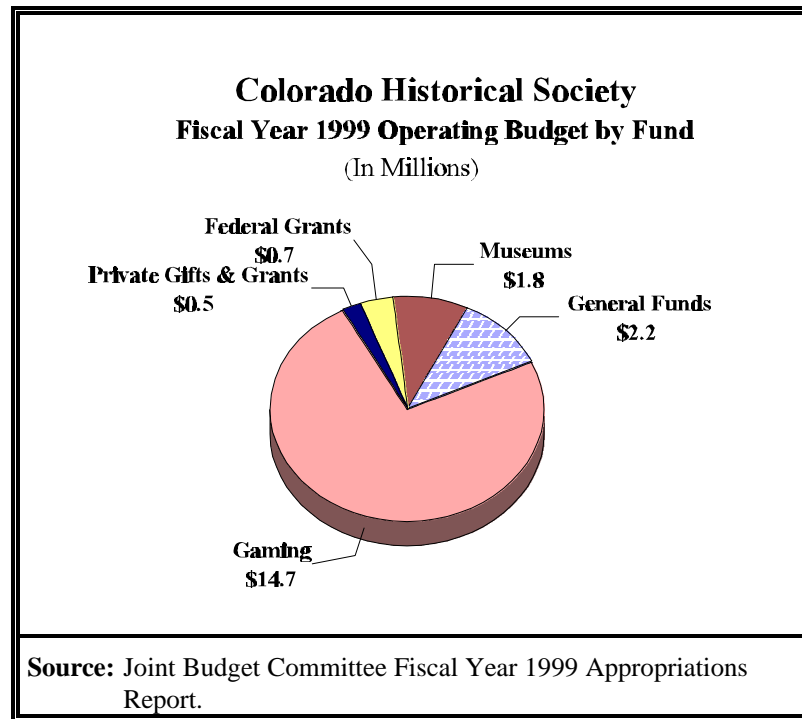
The University of Colorado Health Sciences Center should ensure compliance with federal and University regulations, policies and procedures concerning grants purchases and disposition of federally-funded assets over \$5,000.

University of Colorado Response:

Agree. New procedures are in place to ensure compliance.

State Historical Society

The State Historical Society, founded in 1879, is an educational institution of the State and acts as trustee for the State in collecting, exhibiting, and interpreting collections and properties of state historical significance. The Society maintains museums and historical sites throughout Colorado and provides assistance to local and regional historical societies and museums. The Society also distributes funding to gaming cities and administers a statewide grant program for historic preservation. The Society operates on a budget of \$19.9 million with 106.1 full-time-equivalent staff (FTE). The following graph shows the Society's source of funds for its Fiscal Year 1999 operating budget.



State Historical Fund

The State Historical Fund (SHF) was established in 1990 with a constitutional amendment legalizing gambling in Central City, Black Hawk, and Cripple Creek. The amendment allocates 28 percent of the revenue generated from gaming to the State Historical Fund. Of the amount allocated to the State Historical Fund, 20 percent is returned to the gaming cities for historic preservation projects. The remaining 80 percent of the fund is used to provide grants for preservation projects in all other areas of the State.

Background

Part of the goal of the State Historical Fund is to emphasize local participation and responsibility in the preservation of Colorado's resources. The Society provides grants and financial incentives to organizations and individuals. To receive a grant, an individual or organization submits an application to the State Historical Fund. The applications are reviewed twice a year. The Fund informs the applicants of the outcome of their requests as well as continues to monitor the projects that it chooses to fund. One typical example of a project is enhancements to restore a historical building to its original state.

Documentation is Lacking to Support Monitoring Decisions

The State Historical Fund does not maintain adequate documentation to support the degree to which it monitors projects. There are many aspects that need to be considered when determining the level of monitoring needed. Some of the factors creating variability to decisions are previous experience with the applicant, knowledge of the contractors to be hired by the applicant, the dollar amount of the project, and the nature of the project. Although contact with the applicants is well documented, the reasons as described above for the chosen level of monitoring are not substantiated. In our review of 25 files we could not determine the rationale used to determine the number and extent of site visits performed. Consequently, we could not determine whether an appropriate number of site visits were performed and whether the same basic factors were considered by the different staff members responsible to oversee the projects.

Staff indicated that the level of documentation maintained in the file is largely dependent upon the individual staff involved and that there are no written requirements or policies regarding documentation. A written policy requiring documentation of key risk factors would help provide assurance that all relevant factors were considered. Such a policy would also help to ensure that projects with similar levels of risk received comparable levels of monitoring when overseen by different persons.

Recommendation No. 8:

The State Historical Fund should develop a standard list of key criteria that should be documented for each historical preservation project and that supports the level of monitoring to occur.

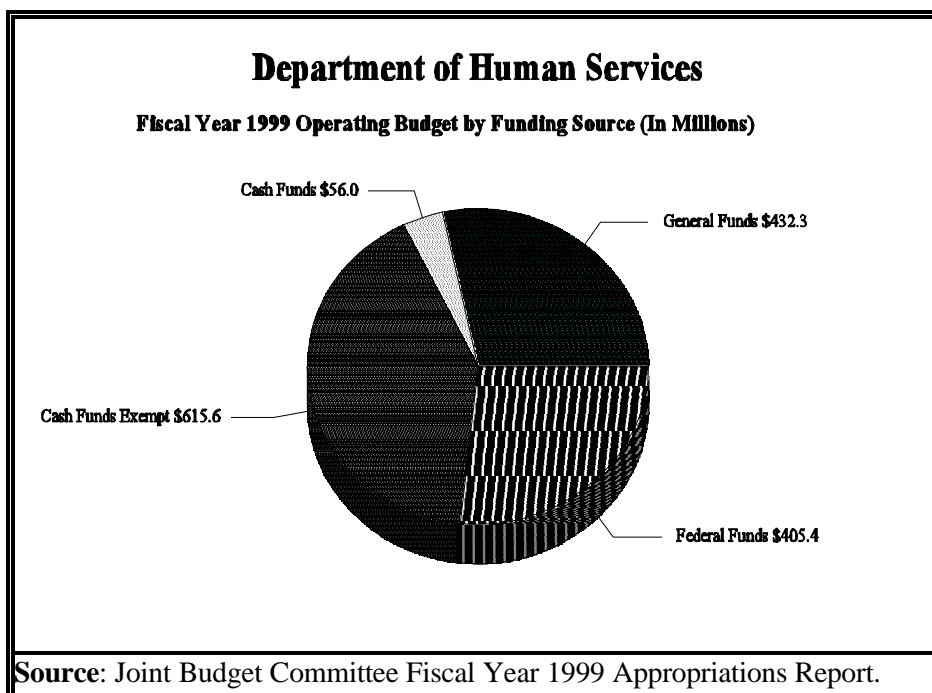
State Historical Fund Response:

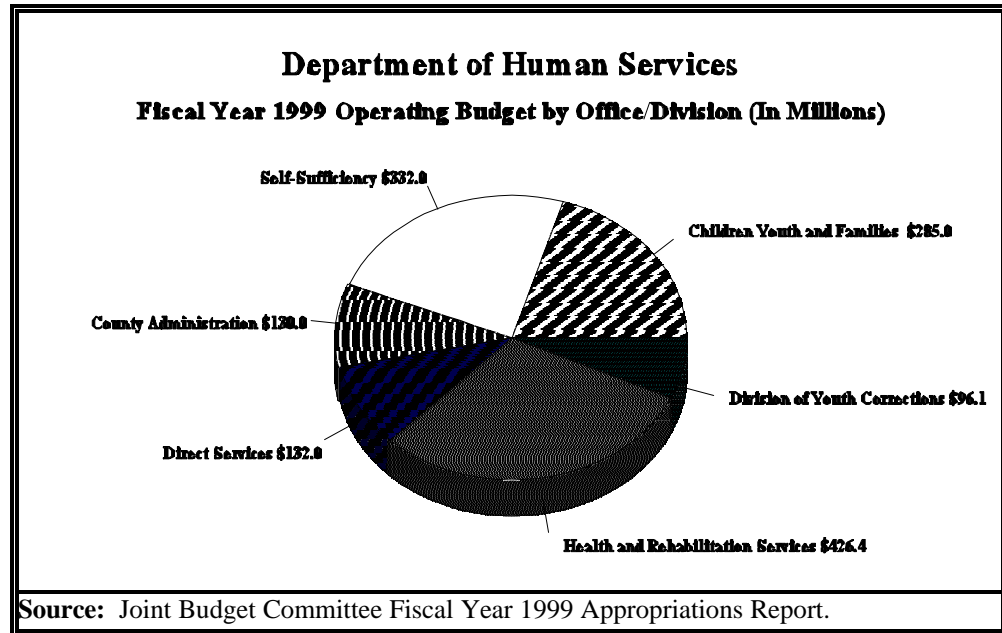
Agree. A list of key criteria has been developed, and incorporated into a report form that is reviewed and signed by SHF staff before their initial contact with each grant recipient. If conditions change as the project is carried out, a new review form is completed. This form has been in use since July of 1999.

Department of Human Services

Introduction

The Department of Human Services is solely responsible, by statute, for administering, managing, and overseeing the delivery of human services throughout the State. Services include the following: Welfare, vocational rehabilitation, mental health, youth corrections, and developmental disabilities. The Department accomplishes its statutory responsibility through a variety of state-operated facilities and programs, county-operated programs, and contractual arrangements with public and private human services providers across the State. In Fiscal Year 1999 the Department expended approximately \$1.4 billion and had 4,464.4 full-time-equivalent staff (FTE). The following charts show the operating budget by funding source and by office/division, respectively, for Fiscal Year 1999:





We reviewed and tested the Department's internal accounting and administrative controls and evaluated compliance with state and federal rules and regulations. Generally, we found the Department to have adequate administrative and internal controls in place to oversee its operations and meet state and federal requirements. We identified four areas where improvements could assist the Department in effectively managing its responsibilities.

Implement Revenue Reconciliation Process

The Department is responsible for the operation of three Regional Centers for the care of developmentally disabled individuals: Grand Junction Regional Center, Ridge Regional Center, and Pueblo Regional Center. As part of our Fiscal Year 1999 audit testwork we reviewed revenue information for the Grand Junction Regional Center (Regional Center).

Grand Junction Regional Center staff utilize the following three information systems for managing patient financial information:

- Medicaid Claim Administration System (MCAS)
- Community Contract and Management System (CCMS)
- Health Information Management System (HIMS)

We found the following problems with the Grand Junction Regional Center's revenue compilation and recording process:

- **Regional Center staff do not periodically reconcile revenue information calculated by the three information systems to information recorded on COFRS.** Staff indicated that revenue information compiled from the three systems and adjustment information provided by various sources is entered onto COFRS throughout the year. However, staff do not on a monthly or yearly basis perform a comparison of revenue calculated using approved rates and appropriate adjustments to revenue reported on COFRS for the same period. We noted that total revenue reported on spreadsheets prepared by Regional Center staff was \$687,051 less than that reported on COFRS for the fiscal year.
- **Regional Center staff do not use an automated system for tracking patient charges and resulting revenue and receipts.** We found that Regional Center staff use various manual methods for tracking this information. For example, staff track accounts receivable activity using a manual ledger.

During our Fiscal Year 1996 audit we noted weaknesses in the revenue compilation and recording processes used at two Department facilities: the Colorado Mental Health Institute at Ft. Logan and the Colorado Mental Health Institute at Pueblo. While the Department appears to have implemented an effective revenue reconciliation process at the two Institutes, our review indicates a need for such a process at the Grand Junction Regional Center.

Reconciliation procedures provide a means for an entity to identify errors and make appropriate corrections to its financial information. In addition, reconciliations may also enable an entity to identify possible inappropriate entries related to misappropriated funds. If adequate reconciliation procedures are not in place, there is greater risk of errors and irregularities going undetected. Since we have noted revenue-control weaknesses at different Department entities at different times, our audit indicates that a reconciliation policy needs to be implemented Department-wide.

The Department should further automate its revenue compilation and receivable recording processes. As noted earlier, Regional Center staff manually track some patient information. We believe the Department should discontinue its manual processes. This will ensure that information is managed more efficiently and with a smaller risk of inaccuracy than with manual methods.

By instituting improved methods for tracking and compiling patient financial information, the Department can ensure that its financial data are properly recorded and that reports provided internally are accurate for decision-making purposes.

Recommendation No. 9:

The Department of Human Services should implement a clear and consistent methodology for accumulating, recording, and reporting revenue within all divisions. This should include:

- a. Developing and instituting adequate monthly and year-end reconciliation procedures that contain all necessary financial information for revenue.
- b. Utilizing an automated method for tracking patient charges, revenue, and payments at all appropriate agencies within the Department.

Department of Human Services Response:

- a. Agree. The Division of Accounting will implement a procedure for all three regional centers to complete a reconciliation process.
 - b. Agree. The Division of Accounting will utilize an automated method for tracking patient charges, revenue, and payments.
-

Further Improve Controls Over Manually Calculated Payroll Transactions

As a part of the Department's payroll process, adjustments are made to employees' pay due to particular circumstances, such as deductions for leave taken without pay or additions for excess hours worked. These types of adjustments are calculated manually outside of the automated payroll system by payroll staff.

During our Fiscal Year 1999 audit we reviewed a sample of three payroll reports prepared by payroll staff at different agencies within the Department. During this review we noted one instance in which an employee was overpaid for additional hours worked. The employee was owed \$87.50 for these additional hours. In one month,

staff made a manual adjustment and incorrectly paid the employee \$525, which was \$437.50 more than the employee was owed. In the following month, payroll staff then attempted to correct this error and made a second manual adjustment and deducted \$350 from the employee's pay. After this adjustment, the employee was still overpaid by \$87.50. Staff then corrected the error with a final adjustment and deducted \$87.50 from the employee's pay in a subsequent month.

This is not the first time we have noted problems with the Department's payroll process. During our Fiscal Year 1996 audit we noted that the Department needed to strengthen its policies and procedures for nonroutine payroll transactions, or manually calculated payroll transactions. In response to our recommendation the Department agreed that the payroll supervisor or another payroll technician would review and initial the calculations for all nonroutine payroll adjustments.

Although the Department implemented policies and procedures for the review of nonroutine payroll transactions, the procedures are clearly not adequate because they do not include the bulk of manual adjustments made. The Department defined nonroutine transactions as those adjustments that payroll technicians do not make frequently. Department payroll staff report that they manually calculate 45-70 payroll adjustments each month, on average, depending on the agency. Of these adjustments, staff indicate that they consider fewer than 10 percent as nonroutine. The instance we noted was not reviewed for accuracy, since the type of adjustment is made frequently and, therefore, is not considered nonroutine by the Department's definition.

We believe that all manually calculated payroll adjustments should be subject to review due to the higher risk of errors with this type of transaction. A secondary review process will reduce the risk of not detecting errors.

Recommendation No. 10:

The Department of Human Services should require supervisory or secondary review of all manually calculated payroll transactions.

Department of Human Services Response:

Agree. The Division of Accounting will require a review of all manually calculated payroll adjustments before the next payroll processing.

Complete Annual Performance Evaluations

Employee performance evaluations are an important part of the personnel system because they allow supervisors to identify and communicate job expectations to employees. As part of our audit work we reviewed personnel files for various attributes including whether employees have a current performance evaluation. Five of the twelve files we reviewed, or 42 percent, did not contain a current written performance evaluation for the employee. Four of these employees' evaluations were one to two years past due, while the fifth employee did not have an evaluation for any of the past five years.

State statutes and personnel rules require employees to be evaluated once a year. This evaluation is to be used as a factor in compensation, promotions, and demotions. Colorado Revised Statutes also state that supervisors who do not evaluate their subordinate employees at least once annually shall be suspended from work without pay for a period of not less than one work week. In addition, personnel rules state that supervisors are to be evaluated on their performance management and evaluation of employees.

This is not the first time we have raised concerns regarding the Department's failure to evaluate its employees. We identified instances of noncompliance in both our Fiscal Year 1998 audit of the Department's Child Care Licensing Division and our Fiscal Year 1996 audit of the Department's Office of Human Resources. Our audits indicate that the Department has not fully implemented an internal, centralized process for monitoring and enforcing the completion of performance evaluations. Thus, it is difficult to monitor supervisors and hold them accountable for noncompliance.

Compliance with the employee evaluation requirements is increasingly important as the Department implements the new Colorado Peak Performance system. This system will allow management to provide monetary rewards to employees based on their performance. Lack of compliance with the performance evaluation requirements may result in employee grievances and potential lawsuits, since some employees would not be receiving consideration for these potential rewards. Conversely, if staff are not informed of unsatisfactory performance, the quality of service the State provides could be lacking.

Recommendation No. 11:

The Department of Human Services should improve controls over the personnel process by:

- a. Implementing a monitoring process for management's use to ensure that employee performance evaluations are completed annually in accordance with state regulations.
- b. Enforcing disciplinary actions against supervisors who do not complete annual performance evaluations.

Department of Human Services Response:

- a. Agree. The Colorado Department of Human Services (CDHS) agrees with this audit recommendation. In 1998, the CDHS Office of Human Resources developed an automated employee planning and evaluation database (CPP Tracking System) in anticipation of our implementation of Colorado Peak Performance. The program was implemented in 1999. The automated planning and evaluation database made it possible for the Department to track and document the Fiscal Year 1999 annual evaluations of our 5,000 plus classified employee workforce. We believe we are in compliance with this audit recommendation.
 - b. Agree. The CDHS Office of Human Resources has utilized the automated employee planning and evaluation database to generate lists of non-complying CDHS supervisors and/or raters and distribute those lists to the appropriate authorities. In addition to the notification of delinquencies, appointing authorities were sent a template corrective action with instructions to issue corrective and/or disciplinary actions as appropriate. As of November 1999, completed copies of corrective actions for non-complying supervisors/raters had been received in the Office of Human Resources. CDHS has implemented this recommendation and will continue to comply with this requirement.
-

Department of Labor and Employment

Introduction

The Department of Labor and Employment administers federal- and state-funded programs, as well as provides inspection and regulation of boilers and the storage of fuel products. The Department has four divisions:

- **The Executive Director's Office:** This office performs administrative functions for the Department. It also administers the Displaced Homemaker's Program and the Industrial Claims Appeal Panel.
- **The Division of Labor:** This division is composed of the Labor Administration, Statistics, and Labor Standards section, and the Public Safety and Inspection section.
- **The Division of Employment and Training:** This division administers the Unemployment Insurance Program, the Employment and Training Program, and the Labor Market Information Program.
- **The Division of Workers' Compensation:** This division is responsible for ensuring the delivery of disability and medical benefits to injured workers at a reasonable cost to employers.

The Department of Labor and Employment was appropriated total funds of \$126 million for 1,123.8 full-time-equivalent staff (FTE) for Fiscal Year 1999. Of the total funds appropriated, 71 percent were federal and 29 percent were cash.

The following chart shows the appropriations breakdown by division in Fiscal Year 1999.

Employment and Training	\$ 78,800,000
Executive Director	22,400,000
Workers' Compensation	20,800,000
Labor	<u>4,000,000</u>
	<u>\$ 126,000,000</u>

The following comment and recommendation was prepared by the public accounting firm of Terry & Stephenson, P.C., who performed audit work at the Department of Labor and Employment.

Reconcile the Schedule of Federal Assistance to COFRS

The Department's schedule of federal assistance (Exhibit K-1) prepared for the State Controller's Office did not agree to the associated revenue balances on the State's financial accounting system (COFRS). The amount in COFRS was \$52,597,992 compared with the amount in the Department's Exhibit K-1 of \$52,391,181. This resulted in an unreconciled difference of \$206,811.

The Department has performed extensive research to determine the source of the difference. Of the \$569,319 beginning difference, \$362,508 was found to be intradepartmental federal revenue recorded for one grant that had not been completely eliminated on COFRS. Intradepartmental revenue occurs when federal revenue is received in one agency of the Department and transferred to another agency for expenditure. Federal revenue is recognized by the agency receiving the monies from the federal government and also by the agency that the monies are transferred to for administering the program. For the Department to properly report the federal revenue actually received, it must eliminate the amounts transferred from one agency to another within the Department. Department personnel are reviewing revenue recorded for other federal grants to determine if the remaining difference is attributable to the same cause.

Although problems were encountered in reconciling federal revenue from the grant accounting system to COFRS, federal expenditures did reconcile. Because federal revenue is recognized as expenditures are made, revenue should always be the same as expenditures. The revenue on the Exhibit K-1 agrees to the reconciled expenditures reported.

Recommendation No. 12:

A reconciliation of federal revenue from the Department's grant accounting system to the State's accounting system should be performed annually and all necessary adjustments recorded in a timely manner.

Department of Labor and Employment Response:

Agree. The Department is currently investigating the sources of reconciling items. Department personnel intend to complete this work and identify the cause of the differences for the Fiscal Year 2000 financial statements.

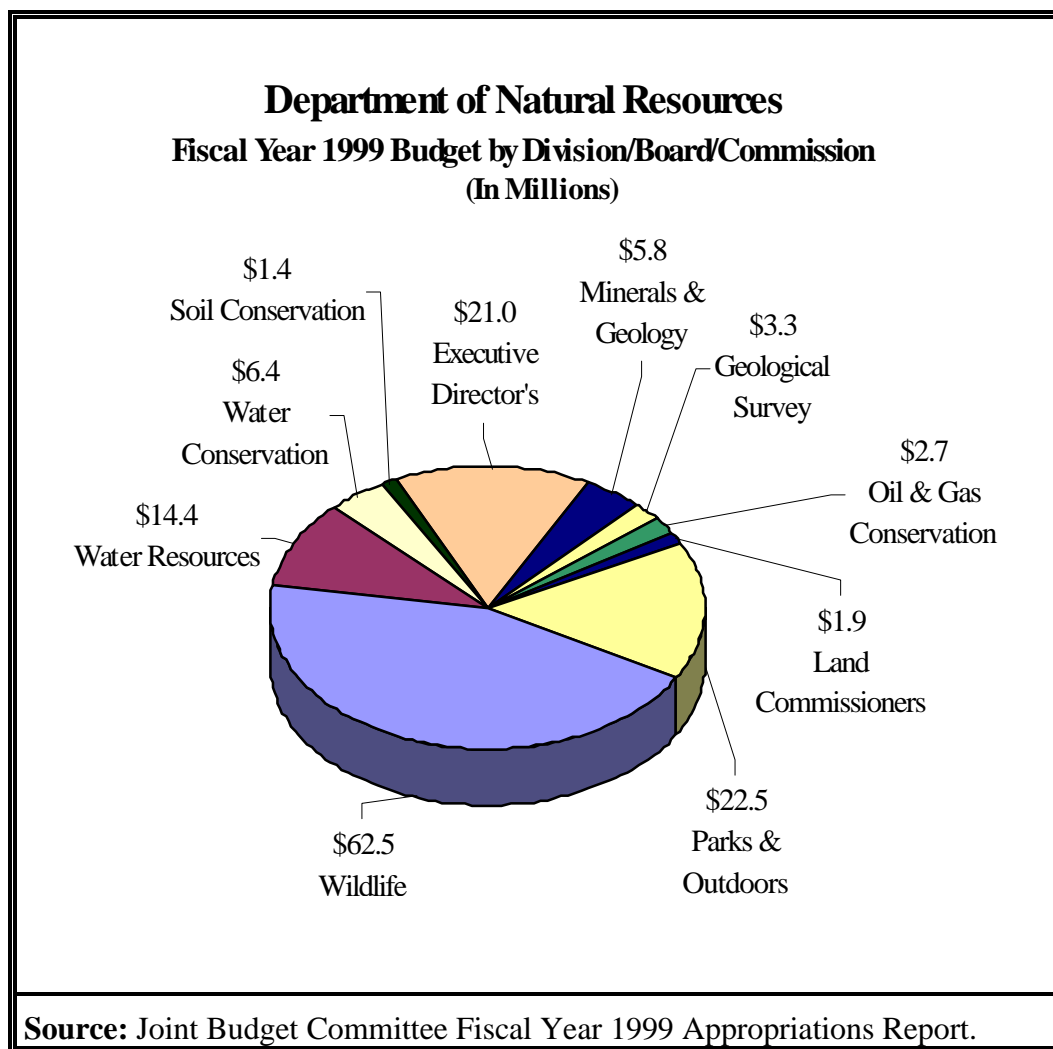
Department of Natural Resources

Introduction

The Department of Natural Resources is responsible for encouraging the development of the State's natural resources. Resources include land, wildlife, outdoor recreation, water, energy, and minerals. The Department operates under the authority of Section 24-1-124, C.R.S., and is composed of an Executive Director's Office and the following nine divisions:

- Wildlife
- Water Resources
- State Board of Land Commissioners
- Soil Conservation Board
- Parks and Outdoor Recreation
- Oil and Gas Conservation Commission
- Minerals and Geology
- Colorado Water Conservation Board
- Colorado Geological Survey

The Department's Fiscal Year 1999 operating budget was about \$142 million and 1,439 full-time-equivalent staff (FTE). The majority of the Department's funding comes from various cash funds, including hunting, fishing, and other licenses; royalties and rents; interest; and other sources. The following graph shows the breakdown of funds appropriated for the Fiscal Year 1999 operating budget by division, board, and commission.



Division of Minerals and Geology

The Division of Minerals and Geology is responsible for regulating the mining activities in the State. This primarily includes overseeing the safety and environmental soundness of mining operations. When mining is complete, the Division is also responsible to ensure that the mine operators return the land to its original state. The program is functionally divided up among coal, minerals, mines, and inactive mines. In Fiscal Year 1999 the Division was appropriated about \$5.7 million to carry out these functions.

Controls Over Mined Land Reclamation Cash Deposits Need to Be Strengthened

During our audit we noted that the Treasury's safekeeping records indicated a June 30, 1999, cash balance of \$476,860 for mined land reclamation deposits. However, the State's accounting system indicated that \$859,995 had been deposited with the State Treasurer-a discrepancy of about \$383,000, or 44 percent of the recorded balance on the State's records. The bonds are held as a means to provide funds to help cleanup mines if the operator fails to return the land to its original state. The Division was not able to resolve or explain the discrepancy.

The Department currently has no procedures to compare the amounts recorded by the Treasury, the safekeeper of the bonds, and amounts recorded on the State's accounting system. Without agreement, the risk of theft is increased. In addition, without an accurate balance, there may not be enough money to cover outstanding claims for mined land clean-up default. The Division would then have to cover such expenses from other sources.

Recommendation No. 13:

The Division of Minerals and Geology should immediately identify discrepancies between the State Treasury's records for mined land reclamation cash deposits and the State's accounting records; and, thereafter, continue to resolve discrepancies in a timely manner.

Division of Minerals and Geology Response:

Agree. The Division and the Department's Controller's staff are reviewing the data on cash bond deposits and comparing agency data with the State Treasurer's information. As discrepancies are found, each discrepancy will require individual review and analysis to determine which data is correct. Appropriate actions will be taken by Division and Controller's staff to correct the discrepancies both on the Division's records and on the State Treasurer's records. Any procedural concerns or deficiencies that are identified through this review will be addressed by Division and Controller's staff and appropriate changes will be implemented and addressed through additional staff training.

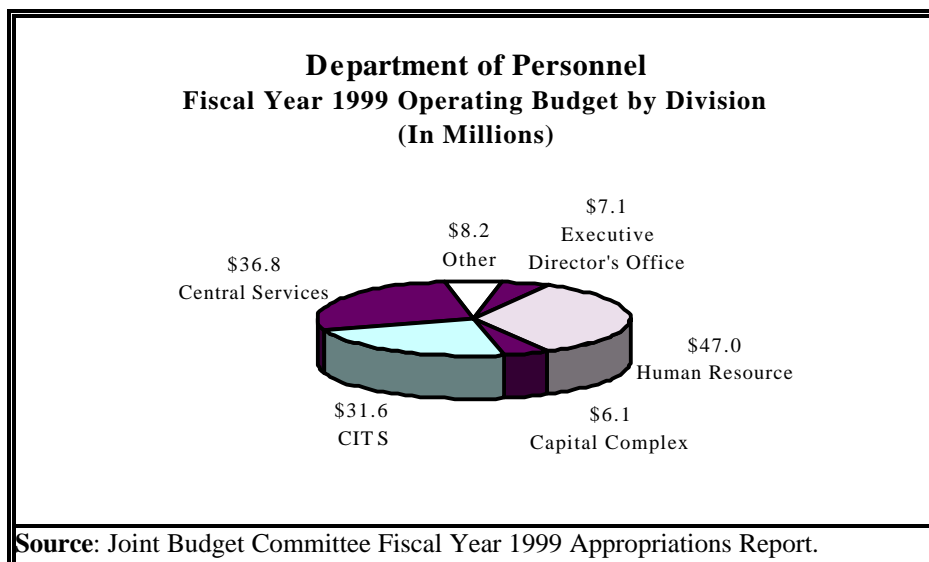
Department of Personnel d.b.a. General Support Services

Introduction

General Support Services' primary function is to support the business needs of state government. The Department administers the classified personnel system, which includes approximately 28,000 employees, and provides general support services for other state agencies. General Support Services includes the following divisions:

- Executive Director's Office
- State Controller's Office
- Human Resource Services
- Colorado Information Technology Services (CITS)
- Central Services
- Administrative Hearings
- Capital Complex Facilities
- Purchasing and State Buildings

General Support Services was appropriated total funds of \$136.8 million and 632.2 full-time-equivalent staff (FTE) for Fiscal Year 1999. Approximately 12 percent of the funding is from general funds and 88 percent is from cash funds, such as vehicle and building rentals, copying, printing, graphic design, and mail services. The following chart shows the operating budget by division/unit for the largest divisions during Fiscal Year 1999.



State Controller's Office

Introduction

The State Controller's Office is part of the Department of Personnel. The Office is under the direction of the State Controller, who is appointed by the Executive Director of Personnel. The Controller's Office is responsible for the State's financial affairs and reporting on the operations of the State as a whole.

The Office's function areas include:

- **Administration.** This area includes the State Controller and the Deputy State Controller, who are responsible for establishing financial guidelines and fiscal policies for the State's agencies.
- **Reporting and Analysis.** This area is primarily responsible for compiling the State's General Purpose Financial Statements as well as various other statutorily required reports.
- **Financial Accounting Specialists Team.** The members of this team provide accounting services to the State's agencies, including performing various analysis, assisting the agencies in implementing new guidelines, and aiding the agencies with specialized needs.
- **Central Accounting.** This area's primary responsibility is to issue warrants for the State's obligations.
- **Cost Accounting.** This area develops the statewide indirect cost plan.

The State Controller's Office was appropriated about \$1.8 million and 27 full-time-equivalent staff (FTE) in Fiscal Year 1999. These are primarily cash funds from indirect cost recoveries and represent about 1.3 percent of the over \$136 million appropriation for the Department of Personnel.

Improve Recording and Reporting of Information for the Statement of Cash Flows

The State Controller's Office coordinates and compiles data from state agencies for inclusion in the State's financial statements. A required statement is the statement of cash flows for business-type activities, such as the State Lottery, State Fair Authority,

and the Colorado Student Loan Program. This statement provides information about where cash came in from and what it was spent on. Users of the financial statements may use this information to look for trends that may indicate strengths and weaknesses in the ability of an agency to finance its operations or to repay its debt.

During Fiscal Year 1999 the State Controller's Office began to compile the statement of cash flows in accordance with the recently issued Governmental Accounting Standards Board (GASB), Statement No. 34. The Statement establishes new financial reporting requirements for governments. When fully implemented in Fiscal Year 2002, it will create new information and will restructure much of the information that has been presented in the financial statements in the past. Because of the enormity of this project, the State Controller's Office began the transition to the new requirements beginning with the statement of cash flows by creating a new program to gather and compile the information contained in the statements.

Currently two methods are available for preparing the statement of cash flows, the direct and indirect methods. The direct method requires specific information about the types of cash received and expended, which are grouped into related categories, for example, fees for services, sales of products, and payments to employees. The indirect method does not require this level of detail. The new standard requires that the direct method be used when compiling the statements. The direct method provides more descriptive information about the source and use of the cash than the method used in prior years.

We reviewed the State Controller's Office's process for compiling the statement of cash flows and found the following:

- **Information presented on the State's statements did not reconcile to the separately issued financial statements required for certain state agencies, for example, Lottery and the State Fair.** The State Controller's Office is responsible for reviewing and approving separately issued financial statements. However, these statements were not used when compiling the State's financial statements. We compared the State's statements with the separately issued statements and found numerous unexplained differences between the two. For example, when comparing an agency's statement of cash flows with the State's, we found \$40 million of cash outflows that were explained as an operating activity on the State's statement of cash flows and as activities other than operating, (for example, financing activities) on the agency's statement of cash flows. Several months prior to our audit we requested that the State Controller's Office work with state agencies to ensure there would be agreement between presentation of amounts on the financial statements. At the time of our audit there continued to be several unexplained differences between the State's and the agencies' financial statements. As a result of our

audit, changes had to be made to the State's and two agencies' financial statements. To provide the most accurate presentation in the future before the State's financial statements are prepared, the State Controller's Office, in conjunction with state agencies, should identify, resolve, and provide adequate detail to explain differences between the State's and the agencies' separately issued financial statements.

- **The State Controller's Office did not use all available information from the agencies to verify the accuracy of the statement of cash flows.** The State Controller's Office has access to information such as exhibits from each state agency containing supplementary financial information, separately issued financial statements, and diagnostic reports which are used to monitor agencies' accounting. During our audit we found inconsistencies between the exhibits and the State's accounting records. In one instance, we found a \$64,000 variance between the two. The State Controller's Office should use all available information to detect errors and verify the accuracy of its information to resolve any differences.
- **Individual transactions are not recorded in a manner that supports the current approach used to prepare the statement of cash flows.** Each state agency is responsible for entering their accounting transactions on the State's accounting system. Agencies can choose between several acceptable methods for recording these transactions. In the past, the statement of cash flows was not affected by the method used to record a transaction. However, the new program analyzes individual transactions and the method by which it was recorded. Changing the way an agency records transactions may require substantial time, resources, and training. The State Controller's Office should work with the agencies to ensure that the method used to record transactions meets both the agencies' day-to-day operational needs and the State Controller's Office's needs to compile the financial statements.
- **Non-reconciling items were grouped together in a line item called "other adjustments" to reconcile the net cash from operating activities, using the direct and indirect method.** Operating activities using both the indirect and the direct methods should net to the same amount. During our audit we found that in order for the two methods to reconcile, the State Controller's Office had grouped \$2.8 million in non-reconciling items into a category on the State's statement of cash flows called "other adjustments." This occurred because the State Controller's Office did not have the information to accurately categorize the items. Subsequent to our discussions with the State Controller's Office, changes were made to regroup this amount into more appropriate categories. The State Controller's Office should refine its

methodology and the accounting used to compile the statement of cash flows to ensure that items are appropriately categorized.

- **Warrants payable are not being netted against cash to be consistent with the separately issued financial statements.** Warrants payable represents checks issued by the State, but not yet cashed. Netting warrants payable against cash will more accurately reflect available cash. We found that warrants payable is netted against cash on the separately issued financial statements and not on the Statewide financial statements, creating inconsistencies between the two statements as to the sources and uses of cash for a specific agency, such as Lottery. Warrants payable should be netted wherever cash is presented throughout the Statewide financial statements.

Currently the statement of cash flows applies to only business-type activities. Beginning in Fiscal Year 2002, GASB Statement No. 34 will require the statement of cash flows to be expanded to include selected higher education activities. This will result in significantly larger cash flow balances than are currently presented and further complicate reconciliation problems that now exist. The refinements should consider the items mentioned above to enhance the usefulness, comparability, and accuracy of the statements.

Recommendation No. 14:

The State Controller's Office should refine the methods used to compile the statement of cash flows by:

- a. Utilizing all available information to verify the accuracy, reasonableness, and logic of the statement of cash flows. Such information could include separately issued financial statements, agency exhibits, and diagnostic reports.
- b. Working with state agencies to ensure that transactions are properly categorized and reported.
- c. Improving the methodology and the accounting used to compile the statement of cash flows to ensure that items are appropriately categorized.
- d. Netting warrants payable against cash wherever cash is presented in the State's financial statements.

State Controller's Office Response:

Agree. This is the first year we reported cash flows using the direct method. This methodology will be required by GASB Statement No. 34 and is a substantial improvement over the indirect method previously used. We recognize that some changes in the accounting will be required to support this approach, and we will work with the state agencies to effect these changes. We will also make sure separately issued agency statements are reconciled to the state's statement. Warrants payable will be netted against cash in the state's financial statements.

Strengthen Procedures to Compile Cash Funds Uncommitted Reserves Report

Senate Bill 98-194 was signed into law on June 1, 1998, to assist the State in complying with the limitations of fiscal year spending that are established by the Taxpayer's Bill of Rights (TABOR). The Bill established a limit on the amount of reserves that may be maintained in cash funds. If a cash fund exceeds the established limit, agencies are required to reduce fees accordingly. The amount of time that an agency has to reduce the fees varies depending on the amount of uncommitted reserves. The uncommitted reserve balance is compared with the target reserve in order to determine whether there are excess reserves for a cash fund.

Senate Bill 98-194 requires that the State Controller prepare an annual report for the purpose of ascertaining the amount of uncommitted reserves for each cash fund. The Cash Funds Uncommitted Reserves Report (Report) was created to meet this requirement. The Report must be delivered to the Office of State Planning and Budgeting and the Joint Budget Committee by September 20 of each year.

Provide Training to Agency Personnel to Ensure Accuracy of Financial Information

The State Controller's Office provides a preliminary Cash Funds Uncommitted Reserves Report to agencies for review of presented financial information. Agencies are to report any differences in amounts within a reasonable amount of time. While some agencies provided corrections to the Report, others did not. Specifically, we noted the following:

- One agency submitted previously appropriated fund balance amounts of \$578,000 for four funds. These amounts did not meet the statutory definition, since they were not for capital construction or other multiyear purposes. As a result, the excess uncommitted reserve balance was understated.
- One agency submitted an alternative reserve balance of \$200,000 that was not supported by statute as required. As a result, the excess uncommitted reserve balance was understated.
- We reviewed the financial information presented on the Cash Funds Uncommitted Reserves Report and noted numerous errors that required changes to the Report. These changes included calculation and reporting errors. While the amounts of the errors noted are not significant, it shows that agency personnel are either not carefully reviewing the information presented in the Report or simply do not understand the specific requirements. These errors were corrected when we notified the State Controller's Office. We are now in the third year of the Senate Bill 98-194 requirements and are still finding errors in the information presented. The State Controller's Office should provide training and work with agency personnel to ensure that all financial information is accurately presented in the report.

Evaluate the Reasonableness of Amounts by Applying Basic Analytical Procedures

Fiscal Year 1998 was the first year that the Cash Funds Uncommitted Reserves Report was statutorily required. During the audit in that year, we noted some items that were incorrectly reported, and the State Controller's Office corrected the items as they were brought to its attention. As previously mentioned, reporting problems continue to exist.

During our Fiscal Year 1999 audit of the Cash Funds Uncommitted Reserves Report, we noted that the State Controller's Office does not conduct tests to determine the reasonableness of the amounts presented on the Report. The State Controller's Office requests feedback from the agencies to help ensure the accuracy of the financial information presented in the Cash Funds Uncommitted Reserves Report. However, comparative fiscal year information is not generated to evaluate the reasonableness of any significant changes. Analytical tools are readily available and can be implemented through the automated system that is used to generate the Report. By generating exception reports, the State Controller's Office can identify and follow up on variances with appropriate agency personnel.

We performed a review of the significant variances in the financial information presented on the Report by comparing amounts reported for Fiscal Year 1998 and 1999. We noted that one fund was incorrectly included on the All Funds Report, since it had been in operation for only one year. The "All Funds Report" is provided to the Office of State Planning and Budgeting and our office for informational purposes and includes all cash funds, even if they do not have excess uncommitted reserves. Senate Bill 98-194 specifically excludes funds that have not been in operation for at least two years. We also found a significant variance of approximately \$798,600 in an uncommitted reserve balance. Further analysis indicated that there was an error in the amount of deferred revenue recorded for an agency.

If financial information is not accurately reported on the Cash Funds Uncommitted Reserves Report, the risk increases that the limit on the amount of reserves will be incorrect. Since the agencies rely on the Cash Funds Uncommitted Reserves Report to ascertain whether a specific fund has an excess uncommitted reserve balance, the accuracy of information is important. Incorrect information could result in some agencies not reducing the amount of the uncommitted reserve balance in the correct amount of time.

Recommendation No. 15:

The State Controller's Office should strengthen the procedures used to compile the Cash Funds Uncommitted Reserves Report by:

- a. Providing training to agency personnel to ensure accuracy of financial information reported.
- b. Developing analytical review procedures to test the reasonableness of amounts on the Report.

State Controller's Office Response:

Agree. The State Controller's Office will develop and train agencies on a two-year comparative report designed to identify significant variances. These variances will be investigated prior to issuance of the report.

Improve the Accuracy of TABOR Revenue Reporting

The Taxpayer's Bill of Rights (TABOR) was added as Article X, Section 20, of the Colorado Constitution in the November 1992 general election. In general, TABOR limits increases in the State's revenue to the annual inflation rate plus the percentage change in state population. TABOR grants qualified enterprises an exemption from the revenue growth limitation. TABOR defines an enterprise as "a government-owned business authorized to issue its own revenue bonds and receiving under 10 percent of annual revenue grants from all Colorado state and local governments combined." Exempt enterprises include the Colorado Student Loan Program, the State Lottery, certain Higher Education Auxiliaries, and State Nursing Homes. As interpreted by the General Assembly in Section 24-77-102(17)(a)(I), C.R.S., the State's revenue base should (1) include revenue from sources outside the State and (2) revenue received by state agencies from the enterprises.

Section 24-77-106.5, C.R.S., requires the State Controller to prepare a financial report (the TABOR Schedule of Revenue) for the purposes of ascertaining compliance with the Taxpayer's Bill of Rights.

Improve and Document Analytical Procedures and Work With Agency Controllers to Determine the Reasonableness of TABOR Revenue

The State Controller's Office provides training to agency personnel that are responsible for recording revenue on the State's accounting system. However, during our audit we noted that the State Controller's Office does not conduct a formal written detailed review to determine whether the amount of revenue reported in the TABOR Schedule of Revenue is reasonable compared with prior years. Although it conducts a high-level review, this is not documented and not sufficient to catch some errors that would be readily apparent with a more detailed review. These tests are easily available through the automated system that the State Controller's Office uses to generate the TABOR report.

We performed simple analytical tests to review the amounts of revenue by groupings such as income taxes, drivers' licenses fees, and fuel taxes. During this review we found an error in the amount of TABOR revenue recorded by the Division of Risk Management at General Support Services. Further analysis found that revenue was overstated by \$2,815,000. This error was not detected by either General Support

Services or the State Controller's Office. We recommended that General Support Services implement procedures to identify the portion of revenue received from enterprises and perform analytical procedures to determine whether TABOR revenue is reasonably stated. See General Support Services recommendations in this report.

The State Controller's Office needs to implement automated reasonableness tests to determine the accuracy of revenue reporting. The reports should be distributed to the applicable agencies and follow-up should be done to determine the nature of the amounts identified. The amount of revenue that was not recorded properly at General Support Services significantly impacted the amount of TABOR revenue. Since excess TABOR revenue is required to be refunded to taxpayers, the accuracy of the revenue classifications is critical.

Recommendation No. 16:

The State Controller's Office should develop improved analytical review techniques, work with Department personnel to test the reasonableness of the amounts recorded as TABOR revenue, and document the results of such analysis.

State Controller's Office Response:

Agree. An analytical review process similar to that performed on the General Purpose Financial Statement will be used. Department personnel will assist in this review process.

Determine Accuracy of Revenue Classifications on the State's Accounting System

We found that General Support Services, specifically the Division of Risk Management, did not properly classify revenue on the State's accounting system for inclusion in the TABOR revenue base. In prior year audits we found that two divisions within General Support Services incorrectly classified revenue received from the enterprises. Improvements have been made at the Division of Central Services' Central Collections Services; however, additional improvements are needed by the Division of Risk Management.

The Division of Risk Management collects premiums from state agencies for the administration of the State's Risk Management Program. We reviewed the amount of premiums received by Risk Management from enterprises. We noted that the amount recorded as TABOR revenue for premiums was \$4,563,979 in 1998 and \$218,709 in 1999. This resulted in a significant variance of about \$4,345,270, or 95 percent, between the two years. Further analysis of the accounts indicated that the amount of revenue received by the Division of Risk Management from several Higher Education enterprises was incorrectly coded. This resulted in an overstatement of TABOR revenue of approximately \$2,815,000. This error was taken into account and adjusted before the TABOR Schedule of Revenue was finalized.

In order to classify revenue received from state agencies and enterprises correctly, General Support Services requests certain information from those agencies it bills for Risk Management services. We noted that the Department did not receive information from the Higher Education enterprises and follow-up was not performed to ensure that all information requested was received. In addition, reasonableness tests were not performed by the Department to determine whether the amount of TABOR revenue for the current year was comparable to that recorded in previous years. Simple analytical procedures would have pointed out the significant variance in the amount of Risk Management premiums received from the enterprises.

We recommended that the State Controller's Office improve its analytical review procedures of amounts recorded as TABOR revenue. General Support Services should utilize the analytical procedures developed by the State Controller's Office or develop specialized procedures specifically for the agency. The amount of revenue that was not recorded properly significantly impacted the amount of TABOR revenue. Since excess TABOR revenue is required to be refunded to taxpayers, the accuracy of the revenue classifications is critical.

Recommendation No. 17:

The Department of Personnel d.b.a. General Support Services should properly classify revenue for TABOR purposes by ensuring that:

- a. There is adequate follow-up on insufficient or inaccurate information submitted from the state agencies.
- b. Analytical procedures are routinely performed on all financial statement information.

Department of Personnel d.b.a. General Support Services Response:

- a. Agree. The Department will routinely follow up on information provided by other agencies that varies significantly from prior information.
- b. Agree. The Department will do annual comparisons between TABOR revenues reported for financial statement purposes.

Central Collections

Central Collections, an agency within the Division of Central Services of General Support Services, is responsible for collecting debts owed to state agencies and local governments. Central Collections uses an internal system to track information on collection activities. The system is also used to track payments and write-offs of collection accounts.

Store the Backup Tapes of Vital Records in a Secured Off-Site Location

During our audit we noted that Central Collections does not store the backup of vital records generated by the internal collection system in a secured off-site location. Back-up tapes are maintained for collection activities and can be used to recreate transaction information in the case of a disaster, data tampering, or malfunction of the internal collection system. We found that the backup tapes are stored near the server.

Central Collections developed a written Disaster Recovery Plan to be used to restore the internal collection system if a disaster were to occur. The plan states that all back-up tapes of vital records related to the system are to be stored off-site.

Recommendation No. 18:

The Department of Personnel d.b.a. General Support Services should follow written procedures and store the backup of Central Collection records in a secured off-site location.

**Department of Personnel d.b.a. General Support
Services Response:**

Agree. Beginning in April 1996 back up Central Records have been secured at the Central Services Mail Room which is in a different location than the Central Collection unit. During a recent system conversion, backup tapes were temporarily stored on-site until the conversion was completed. Since completion of the conversion, back up tapes are again stored off-site.

Department of Public Health and Environment

Introduction

The Department of Public Health and Environment is authorized by Section 24-1-119(1), C.R.S. The Department is responsible for monitoring environmental quality, assuring the quality of health services, and maintaining health data for the State. The mission statement states that the Department is “committed to protecting and preserving the health and environment of the people of Colorado.” The eleven major divisions are as follows:

- Health Facilities
- Emergency Medical Services and Prevention
- Disease Control and Environmental Epidemiology
- Family and Community Health Services
- Center for Health and Environmental Information and Statistics
- Air Pollution Control
- Water Quality Control
- Hazardous Materials and Waste Management
- Consumer Protection
- Laboratory and Radiation Services
- Administrative Services

For Fiscal Year 1999 the Department had an operating budget totaling in excess of \$226 million. This budget supports 1,063.2 full-time-equivalent staff (FTE).

The following comments and recommendations were prepared by the public accounting firm of Johnson, Holscher & Company, P.C., who performed audit work at the Department of Public Health and Environment.

Establish Departmentwide Security Standards for Information Systems

The Department has certain file servers and applications whose primary management and control lies outside of the Information Technology Services Section. Security

standards for these servers and applications, i.e., backup, user access, and policies regarding use of workstations and software at the workstation vary in their level of definition, formality, practice, and completion of implementation.

Regardless of funding sources and administrative control, it is important that all technology used within the Department meet a minimum established departmentwide standard. This should in no way preclude individual administrators from identifying and implementing a level of control higher than the agreed-upon Department security standards.

Recommendation No. 19:

Administrators responsible for technology should establish and implement departmentwide security policies and practices for information systems. Such practices should be monitored annually by the Department.

Department of Public Health and Environment Response:

Agree. The Department agrees that a departmentwide standard is needed to ensure a minimum level of security on all systems and will develop such a policy by December 31, 1999.

The Department Should Control All Third-Party Software Implementations and Perform a Post-Implementation Review

The Department has completed implementation of a new Accounts Receivable application. The application was required to replace an application that was not Y2K-compliant and the implementation intent was to replicate, as much as possible, the processing in place at the Department at the time of conversion.

During the implementation phase some problems have been identified and some processes have required the intervention of the vendor to reset or correct information

processed by the application or entered by users. This has included access to the Department's active database. The designated Departmental vendor liaison is knowledgeable about Departmental procedures and the vendor-provided application. The liaison coordinates all vendor communications and requests for service. However, documentation of the problem, requests for fixes and services, and documentation of vendor actions have not been maintained once the problem has been resolved or request for service completed. A chronological record of each and all vendor access to the Departmental production data and application should be maintained.

Documentation was maintained during the testing and data conversion process by Information Technology Services, but the process was discontinued once control of the system was passed to the users. Such documentation is vital to tracking the history of actions taken by the vendor. It can augment evaluation and testing of formal vendor updates and versions, ensuring that intervening changes have not been duplicated, modified, or replaced. Documentation will verify if problems have been corrected over the long term. It can support passing application knowledge onto other users of the application and for training purposes.

Additionally, the Department has not performed a Post-Implementation Review. The review should be performed after the application is in production for at least six months. The purpose of such a review is to verify that application processes are meeting expectations, that vendor-supplied functions are being used to the advantage of the user, that original user processes have been appropriately abandoned or incorporated into new automated processes, and that the user has full control of the application.

The Accounts Receivable application was implemented in a short time frame to ensure Y2K compliance. To ease the implementation, many processing options of the new system simply replicate those from the old system. However, now that the Y2K-compliant system is in place, the Department should review the processing options that were replicated from the old system to determine whether they are indeed the best options available under the new system. In addition, many outside sources of data interface with the new Accounts Receivable system. The sources and interface methods should also be evaluated periodically to ensure that processing methods remain appropriate.

Recommendation No. 20:

The Department should assemble a team with representatives from Accounts Receivable, other selected divisional source applications, and Information Technology Services. This team should define the procedures for documenting application events, vendor responses, and communicating information to users and support staff. The team should also design, plan, complete, and report on findings of the Post-Implementation Review.

**Department of Public Health and Environment
Response:**

Agree. The Department will assemble a team to define procedures regarding documentation of the Accounts Receivable system and develop a policy to periodically evaluate the data interfaces and processing options being used by March 31, 2000.

Department of State

Introduction

The Department of State's primary responsibilities include supervision and administration of the following:

- **The Colorado Corporations Code.** Corporations are required to file articles of incorporation, merger, or dissolution; biennial reports; and other similar documents.
- **The Colorado Election Code.** Candidates for office are required to file contributions and expenditure summaries, and lobbyists must register with the Department.
- **The Uniform Commercial Code.** Financing statements are filed to provide evidence of security interests for use in determining the rights of the various parties in commercial transactions.
- **Bingo and Raffle Regulations.** Organizations that operate games of chance file various reports with the Department.
- **Commissioning of Notaries Public.** Applications for licensing are filed with the Department.
- Various other laws including voter registration law and the Limited Partnership Act.

In addition, the Department serves as the repository for many official records and documents of state government. The Department's Fiscal Year 1999 operating budget was about \$9.6 million. The Department was authorized 89 full-time-equivalent staff (FTE).

Strengthen Controls Over Financial Transactions

In the prior year audit we recommended that the Department reconcile property and equipment, payroll, and accounts payable. Although the Department has reconciled accounts payable, it has not performed sufficient procedures for property and equipment or payroll, described as follows:

- According to the State's accounting system, the Secretary of State purchased about \$266,778 in property and equipment during the year. However, the Department was only able to provide documentation showing that \$73,940 worth of equipment was purchased. The Department needs to reconcile the difference of \$192,838 to determine if any assets are missing.

On December 13, 1999, we were provided with invoices to support the full amount recorded as purchases of property and equipment. As stated above, at the time of our fieldwork this information was not provided. Current information should be readily available so management has the best information when making decisions.

- The Department has not updated its inventory listing of assets for the items purchased in Fiscal Year 1999. Fixed asset information is important for safeguarding the State's assets.
- The Department has not adequately reconciled payroll activity as recorded on the State's accounting system to the Department's internal payroll system (CPPS). An attempt was made for the first two months of the year, but none subsequently. An analysis of the two systems would assist the Department in ensuring that payroll activities, such as standard deductions, have not been misclassified on either the Department's or the State's accounting system.

Periodic reconciliations are one of the best ways to detect errors in a timely manner so that they may be corrected before the financial statements are prepared. We recommended that the Department implement this procedure in the prior year and continue to stress that it can be a valuable tool for ensuring accuracy and assistance to management in the decision-making process.

Recommendation No. 21:

The Department of State should strengthen the controls over financial transactions by performing and documenting timely reconciliations for property and equipment, and payroll.

Department of State Response:

Agree. The Department of State realizes the importance of strong controls over financial transactions. Payroll reconciliation has been implemented effective July 1, 1999. Documentation on the purchase of fixed assets has been in effect, as evidenced by documentation provided to the auditors. Currently, the Department is planning to reconcile the fixed assets bi-annually. A current listing of all equipment will be available by the close of Fiscal Year 2000.

Department of Transportation

Introduction

The Colorado Department of Transportation is responsible for programs that impact all modes of transportation. The State Transportation Commission governs its operations.

In Fiscal Year 1999 about 76 percent of the Department's expenditures were related to construction funded by the Federal Highway Administration (FHWA) and state sales and use tax funds. The Department's portion of the State Highway Users Tax Fund (i.e., the State Highway Fund) and various aviation-related taxes fund most of its other expenditures. The Department also receives monies from other federal agencies that it passes through to local governments and other entities for highway safety and transportation improvement programs.

The FHWA funds are used for research, planning, and construction of highways. The State Highway Fund pays for highway maintenance and operations and about 49 percent of any highway construction not covered by FHWA funds.

The public accounting firm of Arthur Andersen, who performed audit work for us at the Department of Transportation, prepared the following comments.

Improve Security Over Credit Card Reconciliation System

Starting in Fiscal Year 1999, the Department allowed employees at the job sites to purchase construction materials using Department-issued credit cards. We reviewed the Department's processes for controlling the use of credit cards and the recording of purchases. To assist in sorting and reconciling the credit card purchases, the Department is developing a database program. We found that unauthorized personnel may be able to access credit card information on the database and that the database is not protected from unapproved changes.

The accounting section at each respective region is responsible for reconciling the items reported on the monthly credit card statement to the supporting documentation provided by the cardholder (employee). Once the monthly reconciliation is complete,

the expenditures are recorded on the State's accounting system. To facilitate this process, one regional accountant developed an automated reconciliation system using a database program. This database program was subsequently shared with the other regional offices to be used as a tool in performing the reconciliation. We found that this program was not thoroughly tested to determine that it will operate as intended. Also, controls were not in place that would ensure that the program and the data files that are processed monthly are not subject to unapproved changes, such as alterations of the amounts reported. Because the data files are not protected, restricted information, such as credit card numbers, could be made available to unauthorized personnel. Without proper security over these files the integrity of the data may be compromised resulting in misstatements of amounts and unauthorized access to credit cards.

The Department should transfer custody of the reconciliation program to its information technology group, who should test the functionality of the program to ensure that it is operating properly. If the information technology group is satisfied with the design of the reconciliation program, the program should be implemented and maintained in accordance with the Department's change management procedures. These control procedures would provide assurance that the program generates valid information by protecting the program and data entered against unauthorized access and change.

Recommendation No. 22:

The Department of Transportation should:

- a. Transfer custody of the reconciliation program to its information technology group to determine whether the program functions properly.
- b. Maintain the program, if it is implemented, in accordance with the Department's change management procedures in order to protect the data against unauthorized access and change.

Department of Transportation's Response:

Agree. The Department has developed a design document to automate financial activities related to the credit card program. Upon completion of this programming effort the Credit Card program will reside on CDOT's main computer system. Phase 1 includes the generation of transaction reports, payments to the issuer of the credit card (bank), and system security. Phase 2 provides for access by CDOT Regional Business Offices,

Regional transaction processing and related reports. Phase 3 will provide for the archiving of data related to the credit card program. Implement September 30, 2000.
